Chapter One

Back to the Future?

Once upon a time, China, India and other Asian and Middle Eastern countries did shape our world, and for many centuries China was the biggest economy and most populous country on the planet. Before 1500, China was, by all accounts, a great power, and even though other dynasties and empires in Asia and the Middle East existed before or emerged subsequently, China retained a prominent, if not dominant role for at least another 300 years. In 1820, China still accounted for about a third of world output.

The years 1500 and 1800 are often referred to as global 'tipping points'. The former corresponds roughly to the surge in European maritime and navigational zeal, not least following Christopher Columbus' voyage to the Americas, while the latter more or less identifies the point at which China's relative decline, compared

with Europe, turned into absolute decline and effective obscurity on the global stage.

After the beginning of the 19th century, China went into an economic decline that continued into the first three decades of the People's Republic. It is of no small consequence to ask how and why this decline occurred, bearing in mind that China had once been decades, if not centuries, ahead of Europe in the development of agriculture, industry and social organisation. The purpose of this chapter is to see what lessons can be drawn as we ponder whether or not today's uprising is taking us back to a long-forgotten global system. In other words, have the last two hundred years of Euro-centric historical focus and economic development simply been a short aberration in over 2000 years of economic and political history?

This is important for two reasons. First, it isn't only China among the world's emerging nations that is making waves in the global economy. The balance of economic power is clearly shifting towards Asia, including the heavily populated countries of India and Indonesia, and the manufacturing hubs of South Korea, Taiwan, Malaysia and now, Vietnam. Second, the contemporary debate focuses on simple economic measures, such as GDP growth, exports, financial flows, and infrastructure development as signposts of the rapid emerging market 'catch-up' relative to the US, Europe and Japan. It is, however, underlying geopolitical, demographic and institutional characteristics and trends which will be far more important for how economic power will be configured in the global system of the future. In thinking about how China may shape or shake the world, it is worth going back to the future and to the time when the balance of power lay in the Orient, and when Europe emerged to dominate the global system.

Once upon a time

In the West, we pay scant attention to the way the world used to be organised and structured. We learn about the Roman Empire but few people are aware that in the first century the Han dynasty in China, straddling two hundred years either side of the birth of Jesus Christ, had achieved a comparable level of development to the Roman Empire[1], or that China, then more of an empire than a country, was even then the largest economy in the world.

We learn about life in the Middle Ages, the succession of kings and queens, the Crusades, the Black Death, the siege of Vienna and other events, but often without proper geopolitical context. Little, if any, attention is paid to the development of Chinese, Indian and Arab civilisations. Normally, in this whirlwind tour of how we got to where we are today, we move swiftly on, as it were, to Columbus and then, by way of the exploits of 16th century Portugal, 17th century Netherlands, and 18th century Britain, to the Industrial Revolution and European hegemony.

The Euro-centric version of world history neglects the fact that, for centuries, Europe comprised a collection of interesting but warring and unremarkable societies on the periphery of an interconnected and multi-polar global system. China's Ming and Qing dynasties (1368–1911), and the empires of Persia (Safavid, 1500–1722), India (Mughal, 1526 to mid 19th century), and the Ottomans (1299–1922) were of far greater significance than Europe before the Industrial Revolution[2].

In contrast to these civilisations, which were spread over large landmasses and unified by secular or religious leaders, Europe was handicapped by its geography. The ice and large water masses to the north, west and south, the vulnerability to invasion from the

east, and the internal geography of mountain and river systems all contrived to make and keep Europe geopolitically incoherent and 'balkanised', literally, into competing states.

The demographics of Asia and Europe offer some insights into their economic development, not least because of the paucity of other economic data, but also because bigger populations typically meant bigger production and bigger armies. The population of Europe in 1000 is estimated to have been about 40 million compared with about 170 million in Asia, which corresponded to roughly 60% of the world's total. By 1750, Asia's population had grown to 600 million, or about 68% of total population, outpacing Europe's population increase which reached about 140 million.

Angus Maddison estimates that China and India accounted for about a half of world GDP, and twice that of Europe for the 600 years until about 1700. By 1820, both countries were still one and a half times as big as Europe[3]. The higher level and faster growth of population in Asia contributed to the higher level of output overall, but in terms of output per head, the two large Asian countries had begun to slip behind Western Europe during the 15th century, possibly earlier.

Thomas Malthus, an English 18th century scholar, proposed that rapid population growth would be self-correcting because it would outpace food production, and that famine and war would result[4]. If he had been right even then, however, China and India would not have been able to support a fourfold expansion in population and nearly treble output per head of population over this period. Even if we are sceptical about economic statistics from long ago, the evidence of continuous, if erratic, progress in the development of agriculture, trade, industry, urbanisation and culture, leaves no

question that China was the most advanced civilisation in the world.

By the end of the 19th century, however, something had changed and China began a lengthy period of upheaval and secular decline. In 1900, it represented little more than 13% of world GDP. Following the Russian revolution, the Chinese Communist Party was formed in 1921, first collaborating with but then fighting the Chinese Nationalist Party, or Kuomintang, which captured Beijing in 1928 and set up a government in Nanjing. Both sides were preoccupied with the Japanese occupying forces during the Second World War, but after the Japanese surrender, the Communists took up arms against their nationalist foes.

By the time Mao Zedong led the Communist Party to power in 1949, China's world population share had fallen to 20%, and its world GDP share had fallen to 5%. China experienced several sequential and disorienting political shocks, including collectivisation and cooperativisation in agriculture (1955–1956), the Great Leap Forward, or forced restructuring of industry and agriculture that resulted in terrible famine (1958–1961), the Cultural Revolution, or revolutionary campaign to purge China of liberal bourgeois forces (1966–1969), and subsequent political instability until 1976. Throughout this period, China stood still economically, and did not stir until sweeping reforms were introduced in 1978.

So, what happened? If Asia had been the dominant part of a global system for many centuries, why did it falter, going first into relative, and then absolute decline? Why did the Industrial Revolution, which transformed Europe and then America, happen in an unknown village called Coalbrookdale in Lancashire in northern Britain, not in the Yangtse delta, which was China's most

populous and dynamic region? To answer these questions could fill several books, and provoke endlessly heated and complex debates among economists and historians[5]. Here, I can only sketch out the very broadest of contours of the shift in power from the Orient to the West. Yet this search for answers reveals important insights into our understanding of today's uprising in China and other emerging markets.

The role of geography, ecology and maritime adventure in economic development is important, but doesn't tell us anything as far as China's booming factories and America's financial woes of today are concerned. On the other hand, the role played by demographics, technology and institutions, including legal and judicial structures, in driving economic and political development remains as potent today as ever.

A change of heart

Western thought sometimes views China as a giant landmass that has traditionally been inward looking, and economically and technologically backward. The historical evidence does not support this observation, at least not consistently. According to data compiled by Professor Angus Maddison, Asia constituted the lion's share of the global economy for millennia, and China's economy was always at its heart[6].

In the first millennium, China had already made many advances that Europeans would only make much later, for example, in the use of farm cattle and farm implements, the exploitation of crop rotation and new varieties of rice, the production of iron and salt, and textiles and water-powered spinning machines. China had

private ownership, basic property rights (though only for its gentry), productive agriculture, and openness to trade. For a long time, the caravan trails of the Silk Road took spices, silk and cotton out of China, while new crops and payments for trade in silver travelled in the opposite direction. China was the leading producer and exporter of porcelain ceramics, silk, zinc and cupronickel (for coinage), and occupied a dominant position in trading cotton and silk textiles, gold, copper and tea.

Under the Ming Dynasty (1368–1644), China was a populous and agriculturally fertile country. Its inland waterway system was run by a well-educated Confucian bureaucracy. It invented movable type printing technology in the 11th century – some 400 years before Gutenberg introduced it to Europe. It was a country of huge libraries, extensive trading networks, and flourishing industries. China's iron industry produced about 125,000 tons a year (a level of output far larger than in Britain in the early stages of the Industrial Revolution), not least to supply an army of a million.

China invented the magnetic compass, and built huge ships. In 1420, the Ming navy had 1350 combat vessels, including 400 floating fortresses, and 250 ships designed for long-range sailing[7]. Apart from guns, munitions, printing and ships, China also became a world leader in metallurgy and transportation. From what can be discerned from the time, China had a strong edge over Europe in matters of culture, mathematics, engineering, and navigational and other technologies.

Despite China's unquestioned achievements and economic status, history records some interesting developments that go some way in explaining why China was prone to autarky and closing doors to engagement with the outside world, and unable to generate the spark for an industrial revolution. For example, China

pioneered the use of coke in iron ore production several hundred years before Abraham Darby succeeded in the same venture in Britain in 1709. However, just as Darby's ironworks started to boom, the blast furnaces and coke ovens in northern China were abandoned, as the country succumbed to internal rebellions, wars and, later, the commercial intrusion of foreigners. The iron ore industry would not be revitalised until the 20th century, but other aspects of Chinese economic advancement were also compromised during the 18th and 19th centuries. China's canal system was allowed to decay, the army was starved of adequate equipment, astronomical clocks were disregarded, and printing was restricted to scholarly works and not used to disseminate practical knowledge widely or encourage criticism[8].

Consider also China's maritime exploits. In the 15th century, several decades before Vasco da Gama found a route to India, the Chinese mariner Zheng He sailed (1405–1433) to Arabia, East Africa, India, Indonesia and Thailand trading gold, silver, porcelain and silk for exotic animals and ivory. His initial 'treasure fleet' consisted of 317 ships – the largest of which was 400 feet long (compared with Christopher Columbus' 'Santa Maria' which measured 85 feet) – and 27,000 crewmen. Indeed it was the largest fleet assembled for a single voyage until the 20th century[9].

As in industry, so it was in exploration. Just as Europeans began to set sail around the world, China's ships were increasingly docked, as a conservative Confucian bureaucracy, which did not care for conflict, and was suspicious of merchants and traders – and prone to confiscate their property – viewed maritime and naval activities as unimportant or contrary to the interests of the state.

Zheng's maritime expeditions spread Chinese knowledge, products and people as well as his own diplomacy and influence, to other

lands. At home, however, the bureaucracy became nervous that foreigners would become so in awe of China's power and magnanimity to those who acknowledged its symbolic suzerainty, that they would extract economic and political advantages that would be costly, and perhaps ruinous. The Chinese authorities felt they were self-reliant and self-sufficient, and were suspicious of foreign influence. They closed down the open-door policy to the outside world, and the door would not open again in a meaningful way until Deng Xiaoping celebrated Zheng's exploits and the Ming Dynasty's engagement of the outside world in a keynote speech in 1984.

In any event, internal political struggles between factions of the Chinese court eventually culminated in the destruction of the fleets, a ban on the building of ships with more than two masts, breaches of which became a capital offence, and even on ocean-going voyages[10]. China's institutional behaviour clearly compromised its capacity to exploit maritime and other technology for the purposes of economic development. Such behaviour, however, was not the only reason that economic advantage slipped away.

People power

The significance of anecdotes can be overstated, but they conform to political and institutional patterns that run through Chinese history and economic development.

Demographics also play a vital part in economic development. After all, more people mean more workers, and more output. More skilled people mean a higher quality of output and higher productivity. On this basis, China should have had a big advantage over Europe.

The much larger population in China did mean there were more mouths to feed and, consequently, Chinese farmers and households might have had a smaller agricultural surplus to invest. Once basic survival needs had been satisfied, there would have been less produce or money available to save and invest. In Europe, however, the reverse should have happened, where smaller families and lower fertility rates would have resulted in larger surpluses. But if these demographic differences had been really important, Chinese and European economic development would have parted company long before it actually happened.

Moreover, because European populations were much more heavily concentrated in smaller geographic areas, it is possible that the real wages of workers rose faster than in China, where labour was much more plentiful, spread out and cheaper. In other words, higher real wages in Europe could have helped to accelerate and sharpen the incentive to find mechanised and labour-saving devices. In turn, these would have raised the amount of capital per worker, and hence productivity growth. It's a theory, and one of many that have been proposed to explain China's tardiness in economic and industrial development compared to Europe. As I have pointed out, however, China was no laggard when it came to economic achievement until a mere 200 years ago, and held its own in the global economy, even if Europeans were doing a fair bit of catching up until then.

The lie of the land

Geography played an important role in shaping economic and political fortunes. The milder and wetter northern European

climate may have conferred advantages that were not as robust in China's more arid and hotter climate. It could have offered Europeans greater protection against disease, drought and natural disasters. It could have helped to sustain more fertile soil which, in turn, allowed spare agricultural land to be used for animal grazing, the deployment of animals for industrial purposes, and food production. That said, China's cultivation of, for example, rice and beans (as opposed to wheat in Europe, for example), its use of horses in agriculture, and its development of water supplies and waterways for transport and irrigation testify to a comparable, if different, path of agricultural development.

The European climate certainly forced citizens to confront a phenomenon that was less pressing in China – flooding. Eventually, the need to overcome flooding would encourage innovations that led to the steam powered pump and, later, the more generic and industrial use of steam power that would spur the Industrial Revolution in northern Europe.

There are, however, more important geographic factors that shaped China's and Europe's progress. Europe's more complicated geography was an integral part of its political fragmentation. There were no great landmasses to enable armies to establish control, and no broad and silty river areas, such as existed in China, India, and Egypt, to be exploited by mass agriculture. And there were large mountain ranges and forest areas that kept populations separate. Political fragmentation made it much harder to establish a unified system of political control, and encouraged the creation and development of decentralised authority. In turn, this meant there was no monolithic structure, especially of an orthodox or fundamentalist nature, that could determine or alter commercial and industrial development. While the Church or the Romans may

have attempted to rule by proclamation and edict, they were unable to do so in the systematic ways of Ming China or, for that matter, other regional empires in Japan and the Middle East. Centralised authority had many advantages in terms of being able to organise social and economic functions and get things done, but equally its raison d'être served also to restrain economic development.

Asia's empires all faced internal strife and external enemies at various points in their histories, but unlike European states, they held together for long periods of time. This was largely thanks to bureaucracies that were centralised, sometimes despotic, and always conservative or orthodox in their outlook. The benefit of centralised authority was the greater stability of the administrative elite, but against this, the emphasis on the maintenance of traditional ways of life and values, and the desire to impose regularity, common standards, and uniformity restrained initiative, dissent, innovation and commerce. Government and society in Asia were, in effect, indistinguishable. The role of Confucian values and political structures in China has already been discussed, and simply warrants a reference here to the capacity to excel in oversight, conservation and consolidation, but not innovation[11].

The mighty civilisations of China and India were large, relatively stable, and successful but their empires were also rather isolated, with a high tendency towards stagnation. Like Europe, they had to contend with both internal strife and external threats, but they lacked the more intense pressures experienced by Europe's warring nation states to innovate, and steal a technological march on their neighbours[12]. Power structures in China and other empires developed, and survived shocks, and did so with great success. Eventually, however, isolationism and conservatism were to cost them their place in the world order.

Standing on the shoulders of giants

There is a fascinating argument that European economic ascendancy was bought, or possibly even hijacked, as its explorers, navies and merchants forcibly clambered on to the shoulders of the giant Asian economies. Christopher Columbus was not the first person to set foot in the Americas, but he is credited with the discovery, even though he did so accidentally, having estimated incorrectly the circumference of the Earth. He was actually looking for a faster route to the East Indies than the journey by land through Arabia and central Asia. If successful, he thought, Spain would gain access to new markets and, importantly, a comparative advantage in the trade in spices and other products, hitherto run by Arabs and Italians. In the 10th to the 15th centuries, the city-states of Venice and Genoa, for example, had become well-established industrial and wealthy trading centres, forming a bridge between Europe and the East. However, Columbus' exploits, and six years later, Vasco da Gama's circumnavigation of the Cape, were important contributors to their decline.

European navigators had strong interests and incentives, as well as advanced scientific and navigational know-how, to 'globalise', as we might call it nowadays, or to bring Asia into their masters' commercial orbit. The discovery of the Americas bestowed unexpected new riches of gold, silver and other precious metals upon Europeans, who used their wealth to build and finance trade in goods with Asia, trade in slaves with Africa, and increased access to new and bigger markets in Asia, and rising prosperity at home.

In effect, the Americas provided the capital for Europeans to compete with, and infiltrate what was already, a Sino-centric economic system in Asia, with a long commercial reach. They did so

often using armed force, and later through a full-blooded colonial system, though not in the case of China. The combination of wealth, guns, ships, and a drive to explore and expand, were key determinants of Europe's ability to climb on to the shoulders of Asia's eastern giant, and then to reach for global hegemony[13].

Even as China's relative decline began, Adam Smith, grandfather of economic thought, noted in his book, *The Wealth of Nations* (1776), that,

> 'Even those three countries (China, Egypt and Indostan, the wealthiest, according to all accounts, that ever there were in the world, are chiefly renowned for their superiority in agriculture and manufactures……China is a much richer country than any part of Europe.'[14]

Smith knew, though, that change was afoot. He claimed that the discovery of America and the sea passage to the East Indies via the Cape of Good Hope had been two of the most significant events in the history of mankind, and that they were 'game-changers' for the world order that favoured Europe. The significance of the Americas lay in the enrichment provided by the discovery of gold, silver, precious metals and new markets. The faster route to India and the Orient allowed Europeans to capitalise by, in effect, buying a place at the global economic table, and implanting themselves into the profitable trading routes inside Asia, and between Asia and Europe. Backed by force and driven by the search for riches, spices and exotic Asian products, Europeans created global trading companies and penetrated the Asian economy.

Seventy-two years later, in the opposite ideological corner, Karl Marx and Friedrich Engels argued in the Communist Manifesto that these two events had breathed life into the rising European bourgeoisie. They had encouraged the development of commerce,

navigation and industry, thereby helping to fuel Europe-wide revolution against feudal societies. For Marx, these stimuli to the development of capitalism in Europe were pivotal to its industrialisation.

Innovation, imagination and institutions

Something is still missing, because we still don't know why continuous and broad-based technological innovation succeeded in Europe and not in China.

Economic development happens as a result of the application of more labour, more capital per worker, and what economists call total factor productivity (TFP). This is the extra growth that occurs when you mix labour and capital together in an efficient and optimum way. We don't actually know all that much about how to measure TFP properly even today, let alone how to assess its role in centuries gone by. What we do know is that it's very important. TFP can come from having good infrastructure, top quality education and training systems, efficient organisation of work and management, a strong bias towards innovation, and research and development, sound economic and financial governance systems and, importantly, robust institutions that facilitate change and improvement.

Great powers, in other words, cannot become, let alone stay, great just because they are good at trade, or have copious reserves of rice, wheat, coal, oil, or money. They need to be able to foster and exploit continuous technological innovation. Their citizens, scientists and leaders must have the imagination to (excuse the cliché) dream. They must have high quality institutions to protect the property rights that exist in every human interaction, and also

to secure transactions, and safeguard contracts. Property rights may refer specifically to property, such as a house, in the narrow sense, but are generally defined to encompass rights to physical property, natural resources including land, intellectual property rights, including knowledge and information, and the services of labour. Courts normally determine how property rights are created, altered, transferred or infringed, and adjudicate in the event of disputes.

In Europe, for example, the ending of feudal constraints on the free purchase and sale of property paved the way for major changes in social class relationships, This gave rise to the subsequent development of free labour, trade and merchant capital. Eventually these led to new forms of entrepreneurship, and a raft of institutional innovations such as non-discretionary legal systems, accounting and book-keeping, access to credit and insurance, new organisational and management techniques, and family systems that facilitated capital accumulation[15]. I shall return to this theme in the concluding chapter.

The German sociologist, Max Weber, argued that the principal, though not sole, catalyst for European economic and industrial success was the impact of Protestant religious belief from the 16th century onwards, as it pertained to values regarding work, initiative, investment and knowledge. In effect, a devout Protestant would live a life of disciplined self-denial and hard work, both of which God would approve. As a result, people would conform to a culture based on both, which, in economic terms, amounted to the 'capitalist spirit'. The Protestant work ethic was, therefore, the driver of an unplanned, autonomous and uncoordinated mass movement that defined and shaped the development of capitalism.

Weber contrasted Protestantism to religions practised elsewhere that were based on mysticism, myth and magic. Indeed, Weber and his followers have attributed, controversially, Asia's failure to compete with Europe to Asian societal norms and culture, including Confucianism itself. Specifically, in China, the state was the defining form or social organisation, and had strong vested interests in uniformity and continuity.

Weber's thesis, first published in 1904, has been heavily criticised, mostly from an ideological and conceptual standpoint, in particular by those who deny that religion has got anything to do with economic progress. A more quantitative way of approximating the impact of Protestantism on economic development, compared with other factors, also asserts that religion had no particular role to play[16]. In one respect, at least, Weber had a point. There was no plurality of power in China. The corollary of a rigid, conservative, and ideologically orthodox economic and political system was an inability to reconcile its own codes and dogma with the freedom to enquire, experiment and improve – except at the risk of posing threats to the State.

China's bureaucracy, craftsmen and peasants were hardly backward when it came to technical progress, but they did not revolutionise China in the way that their peers in Europe did. In general, Asian empires were good at invention, often long before Europe, and adept at exploiting knowledge, based on experience. Thus, if you discovered on-the-job, as it were, how to do something better or more efficiently, that would count as progress. The knowledge of how you do things is important, and vital to invention.

This is different, however, from the exploitation of knowledge based on scientific experiment, which is the knowledge of why

things happen or work, and of how to improve their effectiveness. This is about the innovation of products and processes which, in Europe, comprised the deliberate and conscious act of conducting science-based research. For example, during the 16th and 17th centuries, Europeans recognised the ability of human beings to transform the forces of nature, and developed crucial products such as telescopes, microscopes, clocks, watches and other precision instruments. In general, these were essential to empirical methodology, and specifically, they had a direct influence on navigational skills and the ability to penetrate distant oceans[17]. They made maritime travel less unpredictable as well as more practical. Once the momentum of technological advance had begun, it spread far beyond to armaments, agricultural science, botany, metallurgy, engineering, astronomy and medicine.

Scientific discovery and experiment were at the heart of European industrialisation. As an autonomous method of intellectual enquiry, science detached its proponents from the social restrictions that were imposed by organised religion, for example in the Arab world, and from the political restrictions imposed by centralised authority and orthodoxy, such as in China. In Europe, the Church was not exactly in the vanguard of progressive research, but the diffusion of power in Europe, as opposed its centralisation in other empires, was enough to stunt the influence of religious authority. Latin may have helped too, since it facilitated adversarial discourse in which advances in the physical world could be tested and demonstrated. New inventions and rapid technical progress were catalysts for the transformation of knowledge and of society, and contributed to an array of social and legal changes that, in turn, changed the region's institutions in ways that were more conducive to modernity.

That was then

There is no single explanation for the fact that China and other ancient civilisations were not the first to industrialise and take the path to modernity. It is a long and complex story, taking in everything from mountain ranges and river systems, to birth rates and social organisation, maritime exploits and the discovery of gold and silver.

We should reject the notion that some sort of religious superiority lay behind the Industrial Revolution and capitalist development in Europe, partly because Protestantism didn't stop other civilisations and cultures from joining in. The idea, however, that the West had or has some sort of inherent cultural advantage is one that resurfaces periodically. As recently as the 1990s, after the collapse of communism in Russia and Eastern Europe, some were convinced that the only possible model for human organisation in the modern age of communications and industrialisation was one based on market economies, and limited, pluralist and democratic government[18]. This was pure hubris, or alternatively a version of cultural triumphalism, which was patently wrong and a demonstration of arrogance.

Since the financial crisis, Western thinkers have become more introspective and cognisant of the ways of other countries. Yet there is much in Western culture and institutions that will help us to adapt, to be creative and reinvent ourselves, even if not all Western countries are able to live up to this billing. If that were to be true over the next two to three decades, the reasons would almost certainly lie in flexible institutions, the primacy of the rule of law, and the ability of societies, even if under extreme duress, to challenge the status quo, undertake structural reform, and

innovate. It would stand in stark contrast to the experience of Japan, where a strong bureaucracy and a national pre-occupation with social consensus and cohesion have prevented the country from taking the kind of risks that are essential if the deep consequences of the 1990 financial bust and simultaneous rapid ageing are to be controlled and overcome.

And that is probably the main lesson from history. China's ancient political structure, the culture of its bureaucracy, the legal system, and the overall quality of its institutions were simply not up to the task. They had a negative impact on the country's willingness and ability to consider radical change, and embrace technical progress across a broad range of activities. A large bureaucracy, as opposed to a developing and dynamic legal system perpetuated a culture of conservatism and uniformity, when experiment, change and openness to external ideas were required.

How then should we assess China's prospects, and those of other emerging nations in the second decade of the 21st century? Although the Chinese Communist Party's commitment to full-blown Marxism is now history, has China changed so much, compared to its past?

Further afield, does India's democratic model function in a far more cumbersome, but ultimately more efficient and sustainable, manner? And as Brazil, Mexico, and Chile plant seemingly stronger democratic roots, could they too look forward to greater political stability and the capacity to manage economic cycles more successfully than in the past? After all, these countries are hardly simple export junkies. India is about world-class service-producing industries, and Brazil is about natural resources, oil, and a deservedly good reputation in manufacturing, including of short-haul aircraft. Mexico is quite

diversified across agriculture, energy and manufacturing, relatively rich, and exposed to a wealthy northern neighbour.

Good institutions matter. Consider, for example, that the Asian Tiger economies (South Korea, Taiwan, Singapore and Hong Kong) recorded extraordinary economic growth and development and became benchmarks for the developing world. Hong Kong is a bit of an outlier in this group, because its ascent was not driven by a strong central authority, it had good judicial though not strong political institutions, and it didn't rank as well on educational achievement – and still doesn't. But there's no question that as a group, they achieved something quite special.

At the beginning of the 1970s, their demographic structures, labour force and savings characteristics, and incomes per head were comparable to those of the major countries in Latin America. The Tigers went on to become developed nations to all intents and purposes, whereas Latin American countries remain emerging, at best, but for the most part developing countries.

The main difference is that the Tigers developed strong political institutions, encouraged openness in their economic structures, made rapid strides in educational attainment, and became able to acquire and utilise new technologies – all under the watchful eyes and management of a strong centralised authority.

It's a good cat so long as it catches mice

China has employed the same Tiger model, with rather more emphatic central authority, but with a twist. After the Cultural Revolution had laid waste to the economy, China endured a lengthy power struggle in which Deng Xiaoping eventually

returned to the pinnacle of the Communist Party following Mao Zedong's death in 1976. Deng had fallen out with Mao and been sent to work in a tractor factory, while his family had been targeted by the Red Guards who caused his son severe and permanent injury. Many years before, at a party conference in Guangzhou, Deng is reported to have said, 'I don't care if it's a white cat or a black cat. It's a good cat so long as it catches mice.' This has been interpreted as revealing Deng's belief that productivity was ultimately more important than ideology, per se, but whatever he meant at the time, there is no question that it was he who in 1978 set China off on the road to economic success. And in this sense, he clearly demonstrated that China could break from its past, could pursue political reform on a grand scale, and could be receptive to outside ideas and influence.

Deng's reforms, which consigned many post-1949 orthodox doctrines to history, aimed to modernise agriculture, industry, science and technology, and the military. He wanted to create a socialist market economy with limited private competition, which was open to foreign investment, and responsive to and engaged with the global market. To this end, the reform programme introduced significant changes in the organisation and structure of farming and industry, and sought to emphasise higher agricultural productivity, the development of light industry – or what we could call 'toys and textiles' – and the promotion of export-led growth. In these ways, China would generate the revenues that would be ploughed back into technological advances and capital spending that would, in turn, drive the economy forward. How right he was.

For about ten years, China's agricultural sector experienced an extensive transformation – for the first time since the disastrous collectivisation of the 1950s. Rural incomes rose, based on a

sustained rise in agricultural labour productivity, and farmers were allocated some property rights so that they were allowed to retain a larger proportion of their available surplus for consumption, savings, and investment. This also reflected the pattern of modernisation in, for example, Japan, South Korea and Taiwan, where industrialisation went hand in hand, more or less, with increases in rural welfare.

Since the 1990s, however, the rural sector has been left behind by even greater and more rapid industrialisation, as the focus has shifted from light to heavy industry, such as steel, cement, iron ore, metal fabrication and automobiles. Since two thirds of China's workers are employed in rural areas, it is essential for economic stability and social tranquillity that the countryside be allowed to catch up. I use the phrase 'be allowed' because the solution lies firmly in the hands of the political elite of the Communist Party, and its ability to engage in new structural reforms, and challenges to the economic status quo.

Deng's reforms and the industrialisation push in the 1990s demonstrate that the Chinese Communist Party can be pragmatic and flexible. The country's achievements in industry, exports, education and science since the reforms began in the 1980s have been nothing short of remarkable. The historian Paul Kennedy wrote over 20 years ago,

> 'While the material constraints upon China are great, they are being ameliorated by an economic expansion which, if it can be kept up, promises to transform the country within a few decades.'[19]

Except for the 1989–1991 period when economic growth collapsed and the authorities acted to clamp down on accelerating

inflation, and on the social unrest captured by the Tiananmen Square protests, China has realised Kennedy's condition. From 1991 until 2004, spurred by the elevation of foreign trade and foreign direct investment as the lynchpins of China's growth model, China's economy grew by 8% per year. From 2005–2007, it grew by 11% per year. Despite the temporary shock of the crisis, bankers, business folk and economists assume as gospel that this sort of performance will continue for many years to come.

Under constant supervision and management by the State, and with labour and capital markets still controlled, the development of market forces and the ambition to modernise have propelled China to become one of the largest economies in the world. Once again, it is the hub of a strong Sino-centric global trading system, and a global creditor, customer and competitor. It is an integral member of the United Nations, was admitted to the World Trade Organisation in 2001, and will be an increasingly influential voice in the affairs of the International Monetary Fund and the World Bank, as voting rights in these institutions shift in its favour (and that of other emerging markets) following the decisions reached in 2009 by the G20 countries. It has become a key participant in climate change discussions and goal-setting, and it has used its position to extend its influence on and relations with other major emerging and developing countries, including India, Brazil, Iran, Saudi Arabia and several oil and resource-producing countries in Africa.

The past and the present are what they are: it is the future that is open to question. China's success has been based on the vigorous attempt to balance enterprise and initiative with a state-centric determination to direct its citizens towards the fulfilment of cherished national goals. Maintaining this balance

will be a challenge of increasing significance in the post-crisis world, and requires four conditions to hold.

First, because of its centralised authority and role, the legitimacy of China's Communist Party – the social contract, if you will – depends on its ability to deliver continuously rising prosperity to its citizens. Most people define this as steady and stable 8% economic growth per year. If it cannot capitalise on continuous boom, and always avoid the bust, renewed social and political instability is possible.

Second, and also because of the structure of power, the Chinese leadership has little margin for error in the conduct of its strategic economic policies. It has to make the right choices and do the right things all the time. By its own admissions, China has become a rather unbalanced economy, in which the coastal provinces, urban dwellers, heavy industry and exports have prospered, and overshadowed the growth in the rural sector, domestic demand and social security. The trouble is that the factions that hold sway in the Chinese Communist Party have strong vested interests in the status quo, even if there is debate among intellectuals and others about the need for change and reform. Moreover, much economic and industrial power in China resides with local governments, which can resist or frustrate Beijing's policies for reform. A failure to redress homegrown imbalances in the next several years poses risks not just to China's growth rate but also existential threats to itself, and to the global economy.

One of the major reasons for the financial crisis was – and remains – structurally unbalanced trade. China is no innocent bystander in this, and needs to take responsibility for its role in this imbalance through appropriate economic, financial and exchange rate policies. It isn't. If it continues to behave and

perform as though the global economy hasn't changed, simply waiting for the status quo ante to be restored, it will run huge risks of economic and financial instability, and be the target of rising protectionism. In fact, there are worrisome signs that China is unwilling to change its economic behaviour and strategy in the global economy, and to take global responsibility. This intransigence could end up worse for China than many currently envisage.

Third, the institutional capacity to adjust will also be tested by China's demographics. China is the fastest ageing country on Earth, and its working age population will start to fall from around 2010 onwards. By 2050, China's demographic characteristics will be inferior to the US on all measures. It has financial resources a-plenty, and the State is in a good financial position to be able to expand social and old age security, but unless it acts soon, it really will become old before it gets rich.

Fourth, the ability to acquire new technologies is being facilitated by the factory-type production of graduates in engineering, science and computing, as rising investment in human capital continues to lift the barriers to economic development. School enrolment and educational attainment levels are high. But acquiring technology or copying it isn't the same thing as innovation. The capacity to innovate, and to reach for the most advanced global technological possibilities, exploiting them for commercial gain and social transformation, still seem to be a long way off. For the foreseeable future, this still seems to be a happier hunting ground for the US and possibly some European countries with a penchant for creativity.

As a general point, and provided that globalisation does not falter, there seems to be little doubt that China and other major emerging markets are poised to continue to catch up the West

in economic terms. It's also almost inevitable that they will leverage that economic strength for political influence and power.

There are, however, two big caveats. First, the extraordinary growth of the last decade is most unlikely to be repeated. Second, catching up is quite a different proposition from China ruling the world, or an Asian century. The longer-lasting ramifications of the 2008 financial crisis and its aftermath have still to play out, especially as they affect the structure of the global economy. Demographic and climate change challenges will become increasingly pressing, and many economic and financial policy errors, and business cycle and political shocks lurk in the next decade or two. The acid test for China and other nations will surely be the responsiveness of governments and whether and how political structures and economic institutions change in a timely way.